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ADVANCE LETTER ON GENERAL BUSINESS CONDITIONS

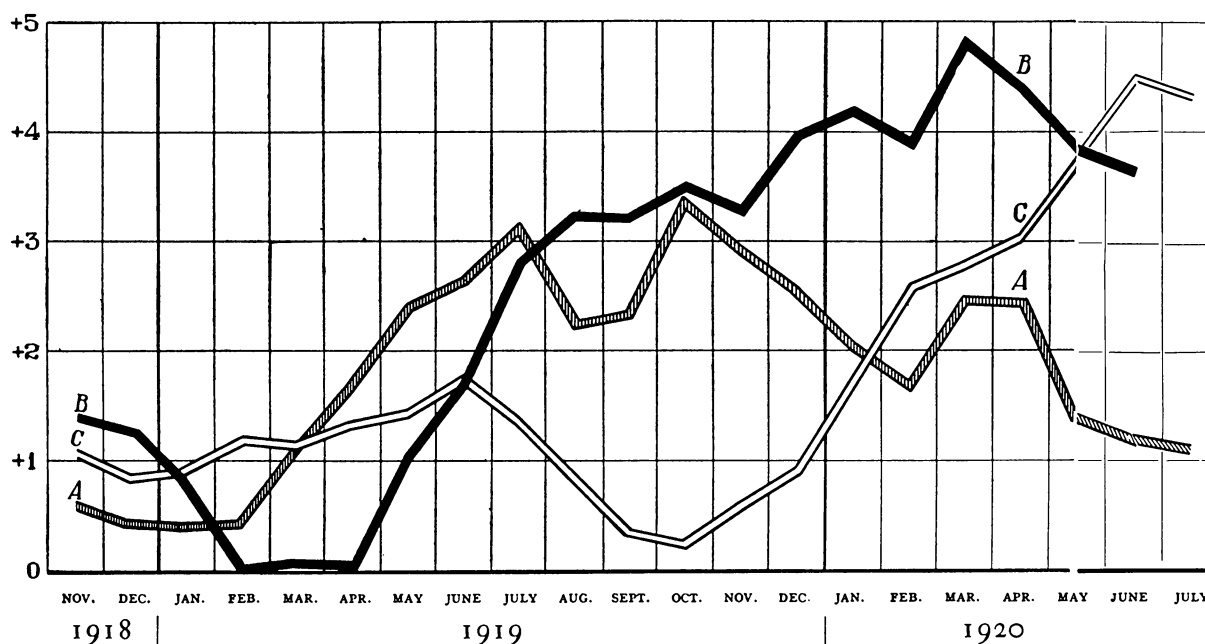
August 2, 1920

TIGHT money continued in July to dominate the situation. Call loans, held most of the month at 8 per cent, rose occasionally to 9 per cent. Rates on commercial paper, after having been quoted without change for several weeks, advanced fractionally toward the end of the month. Corrected for seasonal variation,

wiped out and the market became extraordinarily dull even for the period of midsummer quiet. Further declines in the last week of the month established new low records for the year.

Data for curve B, representing business conditions, are not available at this writing. All reports indicate,

INDEX CHART



GROUP A — SPECULATION: New York Bank Clearings, Shares Traded on the New York Stock Exchange, Price of Industrial Stocks.
GROUP B — BUSINESS: Bank Clearings Outside New York City, Bradstreet's Price Indices.
GROUP C — BANKING: Rate on 4-6 Months Commercial Paper, Rate on 60-90 Day Commercial Paper.

EXPLANATION: Each one of the three curves is based upon a homogeneous group of statistical series, that is, the members of each group have synchronous cyclical fluctuations after having been corrected for seasonal variation and normal growth, and expressed in comparable units. In other words, the corrected series of each group fluctuate together.

Our interpretation of the fluctuations of the three curves of the current index chart is based upon the relationship which was discovered among similar curves for the period 1903-14. All three curves had wave movements, but the upward swings and the crests of the waves were not reached simultaneously. The major movements of speculation preceded those of business by 4 to 10 months, and the movements of business preceded those of banking by 2 to 8 months. The sequence of movements holding for upward swings and crests also held for downward swings and troughs.

The relationship between the curves which held for the pre-war period appears to have reestablished itself in 1919 so that the movements of the curves constitute a basis for forecasting. Our forecasts, however, are not

based solely upon the index of general business conditions, but they allow for the differences in underlying conditions as revealed by economic analysis. During recent months, the persistent rise of rates on commercial paper, curve C, and the decline of speculation from the high point of October, curve A, have forecasted the decline of business activity and commodity prices, curve B.

The duration, rate, and extent of the recession in business activity and commodity prices depend upon the operation of two powerful opposing forces. On the one hand, the shortage of commodities and buildings, abnormal foreign demand for goods and credit, the railroad tie-up, and active retail trade in the United States make for immediate business activity or higher prices. On the other hand, inflated currency and credit, depleted reserves and increasing interest rates, all indicative of capital strain, make for a slackening of business activity and lower prices. At present the money market appears to be the crux of the situation, but we recognize the possibility of the entrance of other factors which may alter the course of developments.

the rates on commercial paper, curve C, maintained without significant change the high level reached in June. The very slight decline of the curve at a time when credit conditions ought to improve greatly in order to enable the banks to meet prospective fall requirements does not indicate that any immediate relief from strained money conditions can be anticipated.

Speculation, curve A, continued to decline during July. The first ten days of the month were featured by considerable activity on the New York Stock Exchange. An advance in quotations led some to believe that the slump of recent months had finally touched bottom and given way to an upward movement. By the fifteenth of the month, however, the gain had been completely

however, that liquidation during July took its normal course. Price concessions were made in many lines of trade and further reductions appear to be in prospect. The weakening of the cereal markets was particularly noticeable. Merchandise stocks are being steadily reduced and orders for new supplies placed with great hesitancy. Heavy cancellations continue to distress several trades. At the same time, inquiries regarding future deliveries seem to be more frequent. The fact that manufacturers' and merchants' stocks of finished goods are in no cases excessive and in some cases deficient should prevent liquidation from getting out of hand. Unless the present acute transportation difficulties place an insupportable burden upon industry

and credit, liquidation should proceed with no disastrous collapse.

SPECULATION

Speculation, curve A, declined slightly during July. An increase in the number of shares sold on the New York Stock Exchange was more than offset by a decrease of New York bank clearings and a decline in the average price of twenty industrial stocks.

The volume of sales on the New York Stock Exchange during July was 12,790,000 shares. This turnover was 37 per cent larger than that of June. Most of the increase occurred during the first part and closing days of the month. Taken as a whole, no recent month except June has shown so little business. Trading was largely professional and the market at times extremely dull.

Weakness was another characteristic of the July market. The average price of twenty industrial stocks fell to \$90.60. In both May and June, the average was \$91.40. An upward movement during the first ten days of July was quickly reversed. New low records for the year were recorded in the last week of the month.

New York bank clearings declined from 20,510 million dollars in June to 18,770 millions in July, a fall of about 8 per cent. Ordinarily June and July clearings are about equal.

BANKING

Rates on commercial paper corrected for seasonal variation, curve C, made no further advance in July, but practically maintained the high level to which they were carried by the advance begun last October and continued into June.

Actual uncorrected rates on commercial paper were a shade higher in July than in June. The 8 per cent rate which had been maintained for several weeks on good single name paper was advanced to $8\frac{1}{4}$ towards the end of July. Simultaneously the rate on choice double name paper was raised from $7\frac{3}{4}$ to 8 per cent. These increases, however, were not as great as normally feature the stiffening of the market during July. The rise in rates, begun in July as the period of crop movement approaches, ordinarily continues until a maximum is reached in September or October. From then until the end of the calendar year slight relaxation is the rule.

The proportions of this movement probably will be less this year than under less strained banking conditions. The rates already prevailing are extraordinarily high. One has to revert to the 90's to find equal monthly averages. That considerable further advances will occur is unlikely. The present rates on commercial paper may be maintained with relatively little change until the market eases toward the end of the year.

The reserve ratio of the combined federal reserve banks on July 30 was 44.2 per cent. On July 2 it was 42.8 per cent. Excess reserves were 287 million dollars on July 30 as compared with 228 millions on July 2. The increase in both items during the month was steady

until the last week. The net gain, however, was relatively so slight as merely to recover the ground lost during the latter part of June. The recovery none the less was reassuring, as any continued decline at this season would be just cause for serious alarm.

BUSINESS

The data for curve B, representing business conditions, are not available at this writing. Further decline of the curve is indicated, however. The volume of trade as reflected in bank clearings outside New York City was probably slightly greater in July than in June. Upon the other hand continued recession of prices probably marked the month. Among the 300 articles for which prices are reported weekly in *Dun's Review*, declines have exceeded advances each week during July. The excess of declines, however, was greater toward the beginning than toward the end of the month. Some of the markets which have suffered most seriously appear to be offering greater resistance to further price reductions. Recent declines in the prices of sugar and cereals are a new feature and may evidence the beginning of liquidation in this direction.

In several important foreign countries prices seem to be taking the same course as in the United States. The crisis in Japan has naturally been followed by price reductions, and a marked downward tendency in many lines is reported to be observable in France, Germany, and the United Kingdom. Sauerbeck's British price index shows a decline of 4.3 points during June. The fall in May was 6.1 points. The price level on July 1 was still 20 points above that of last December and nearly 60 points above the highest mark of the war period. The present swing thus is significant principally as a definite break in the long sustained upward movement of recent years.

In analyzing the business conditions of the different sections of the country the reports of the several federal reserve agents are instructive. St. Louis reports that wholesale "merchants are endeavoring to liquidate their stocks, and are by no means purchasing with the freedom which has characterized their operations during recent months. The course of retail distribution throughout the district during the past month has been more strained and labored." Both Dallas and Minneapolis stress the seriousness of the prospect of fall car shortage. Chicago sees little improvement in the credit situation. Boston reports that "liquidation of consumable commodities in ways pleasing to the ultimate user, which has been so marked during the past two months, continues, but as midsummer passes shows signs of shortly running its course."

In general business appears to be making normally the adjustments required by current deflation. Tight money through the next few months will probably compel further concessions. Meanwhile the transportation situation remains critical and retards industrial and commercial readjustment.